Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Aanestad | Analyst: Colin Stevens | Bill Number: AB 1299

Related Bills: AB 1759 (1995/96) | Telephone: 845-3036 | Introduced Date: 2/26/99

Attorney: Doug Bramhall | Sponsor:

SUBJECT: Medical Care Insurance Credit

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would allow a credit equal to 100% of the amount paid or incurred during the taxable year by the taxpayer for insurance that constitutes medical care for the taxpayer, his or her spouse, and dependents.

EFFECTIVE DATE

This bill would apply to taxable years beginning on or after January 1, 1999.

SPECIFIC FINDINGS

Federal and state laws allow a variety of tax credits and deductions designed to promote or influence specific taxpayer behavior. Neither federal nor state laws allow a tax credit for the cost of insurance for medical care. Prior state law did allow a tax credit for small employers to provide health coverage for their employees and their dependents. However, that credit was enacted with a delayed operative date and repealed before it became effective. Both federal and state laws do allow a credit for adoption costs and costs eligible for that credit include certain medical costs related to adoption.

Federal law allows a deduction for self-employed individuals who pay or incur costs for health insurance for themselves, their spouse, or dependents. The deduction is 45% in 1998 and 1999, 50% in 2000 and 2001, increasing incrementally to 100% in 2007 and thereafter. The deduction is limited to the extent the self-employed individuals have net profits and cannot be taken if they are eligible to participate in their or their spouse's employer-provided plan. If the self-employed person itemizes his/her deductions, the remaining premium costs can be included with all other medical expenses, subject to the 7.5% adjusted gross income (AGI) limit. **California conforms** to the federal self-employed health insurance deduction except the deduction amount allowed is limited to 40%.

For purposes of itemized deductions, California follows federal treatment that allows the deduction of expenses for medical care, which includes costs for medical insurance and long-term care insurance, but only to the extent expenses exceed 7.5% of the taxpayer's federal adjusted gross income.

Existing state law and federal laws require that certain tests must be met including the requirement that the taxpayer provide more than one-half of the dependent's support in order for a person to qualify as a dependent. In cases of

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Department Director: **Gerald Goldberg** Date: **4/16/1999** divorce or separation, the custodial parent generally is allowed the dependency exemption credit unless that parent chooses to release that exemption credit to the noncustodial parent.

This bill would allow a credit equal to 100% of the amount paid or incurred during the taxable year by the taxpayer for insurance that constitutes medical care for the taxpayer, his or her spouse, and dependents.

For taxpayers eligible to claim the deductions discussed above, the credit would be allowed in addition to those deductions.

Any credit that exceeds the taxpayer's tax liability in the year allowed could be carried over until exhausted.

Policy Considerations

This bill would allow a taxpayer to claim both this credit equal to 100% of actual costs, as well as the state and federal deductions for the same expense, thereby creating the opportunity for a taxpayer to receive more than 100% of the costs paid for health care. For example, a self-employed taxpayer could deduct 45% of the cost of health insurance for federal purposes, 40% of the cost for state purposes, and additionally claim this credit equal to 100% of the cost.

This bill would allow a credit equal to 100% of identified costs. As a matter of tax policy, a 100% credit at the state level is unprecedented.

This bill does not specify a repeal date or limit the number of years for the carryover. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. However, even if a repeal date were added, because an unlimited credit carryover is allowed, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover limit since experience shows credits are typically used within eight years of being earned.

The requirement in the federal self-employed health insurance deduction that it cannot be taken if the taxpayers are eligible to participate in their or their spouse's employer-provided plan is not present in this bill's provisions.

Many taxpayers who are unable to afford health care may not be able to effectively use this credit since they would have little or no tax liability against which to apply the credit.

Implementation Considerations

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

Technical Considerations

The term "medical care" is not specifically defined. As a result, it is unclear what expense qualifies for the credit. For tax deduction purposes, "medical care" is defined under federal and state law. It appears the author intends the credit to cover long-term care and supplemental insurance as described in Internal Revenue Code Section 213(d)(1)(D). If that is the intent, the author may wish to clarify the definition of "medical care" for purposes of this credit.

FISCAL IMPACT

Departmental Costs

This bill is not expected to result in significant costs to the department.

Tax Revenue Estimate

Revenue losses under the PIT Law from this provision are estimated to be as shown in the following table.

Fiscal Year Cash Flow Impact Effective 1/1/99 Enacted after 6/30/99 **$ Billions**			
1999-0	2000-01	2001-02	2002-03
($12)	($11)	($13)	($16)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The revenue impact of this provision would be determined by the number of individuals who pay part or all of their health insurance premiums, the cost of premiums, and the amounts of credits that can be applied against available tax liabilities.

This estimate was developed in the following steps. First, according to the 1996 U.S. Statistical Abstract, total national health insurance premium payments were $70.6 billion by households and $179.5 billion by businesses in 1994. Second, household premium payments were grown 7% per year to yield $99 billion for 1999. Third, the business premium payments were grown 7% per year, yielding $251.8 billion for 1999. Fourth, it is estimated that California represents 12% of the national amounts, generating approximately $12 billion in qualified insurance premium payments for households and $30 billion for businesses. The household number was further grown 5% per year for an incentive for taxpayers who do not currently purchase health insurance, but will purchase an insurance premium under this bill to receive a 100% tax credit, yielding $12.5 billion for 1999. It was assumed that 5% of businesses for 1999 would shift premium liabilities to employees in response to the credit, yielding an additional $1.5 billion for 1999. It was further assumed the percentage of such businesses would grow in any given year up to a maximum of 25% by the year 2002 and thereafter.

Combining these two amounts yields approximately $14 billion in qualified payments for 1999. Fifth, it was assumed that two-thirds on average in available tax credits would be applied in any given year. The 1999-0 fiscal year estimate consists of the 1999 tax loss ($9 billion) and 25% of the 2000 impact ($11 billion) reflecting reduced estimated tax/withholding payments. Revenue losses take into account the current law deduction for business expenses that would otherwise be allowed. Losses were grown to reflect a 7% increase in premiums based on current historical averages and 5% for additional premiums being purchased by those taxpayers who currently have no health insurance.

The table below shows the impact on a liability year basis plus the amount of unapplied credits generated each year for carryover purposes.

Taxable Year Impact **$ Billions**				
	1999	2000	2001	2002
Applied Credits	($9)	($11)	($12.5)	($16)
Unapplied Credits	($5)	($5.5)	($6.5)	($8)

BOARD POSITION

Pending.